(5)

No. 85-727

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

THE MISSOURI FARMERS ASSOCIATION, INC.,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITIONER'S REPLY

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19pp

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PETITIONER'S REPLY

In its brief opposing certiorari, the Government avoids grappling with the real and important issues presented by the Eighth Circuit decision and instead attempts to distract the Court from full consideration of this case by stringing together a series of erroneous, misleading, and sometimes wholly irrelevant arguments. In the end, it is what the Government fails to say which is most significant.

1. The Conflict with *Kimbell Foods*

The Government attempts to paper over the conflict with *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), by contending that the specific issue in *Kimbell Foods* (FmHA's priority in relation to other creditors) is distinct from the specific legal issue here (FmHA right to enforce its security interest against non-creditors). But

the Government fails to offer any valid or persuasive reasons for concluding that a different choice of law should be made here, and there is none.[1]

The Government erroneously suggests, first, that unlike *Kimbell*, the FmHA regulations here directly address the question presented. But the FmHA regulations here address only the circumstances under which FmHA will affirmatively *release* its lien; they do not deal with the question of what authorization of sale by FmHA will result in a loss of its security interest in the collateral. *See United States v. Central Livestock Corp.*, 616 F.Supp. 629, 633 (D.Kan. 1985). Surely FmHA cannot "reverse" *Kimbell* by placing its losing argument there into one of its own regulations; but that appears to be the Government's argument here. While this Court in *Kimbell* stated that congressional statutes could supercede the choice of state law for FmHA security interests, nothing in the opinion suggests that the agency could write its own law to govern its own security interests, and such an outcome would violate the congressional policy on which *Kimbell* was based that FmHA *not* be granted special commercial status.

The Government suggests, second, that this case differs from *Kimbell* in that here the issue is one of "waiver" of FmHA security interests, and that it is reasonable to look to the agency's own regulations to determine whether there was a waiver. This, according to the Government,

[1] The leading commentator in this area finds no basis for limiting *Kimbell* to the specific issue addressed:

> Although *Kimbell Foods* involved the first-to-file rule of §9-312 and the statutory lien priority of §9-310, the rationale extends to other priority rules such as exposure for the farm products purchaser under §9-307. [B. Clark, The Law of Secured Transactions §8.4[3][d] (1980), at 8-34.]

would not supplant any state commercial law. But the issue is not one of "waiver", but rather one of authorization of sale. State law specifically recognizes that authorization of the collateral sales by the secured party cuts off its interest in the sold collateral and prevents the purchaser from being held liable for conversion. Mo.Rev.Stat. §400.9-306(2) (1978). Application of FmHA's regulations, however, completely eliminates the long-standing consent defense. Indeed, the Eighth Circuit recognized this conflict between state law and FmHA's regulations and made the conflict the focus of its decision. *United States v. Missouri Farmers Ass'n, Inc.*, 764 F.2d 488, 489 (8th Cir. 1985).

Third, the Government attempts to distinguish *Kimbell* by contending that there FmHA's regulations required substantial agency compliance with UCC procedural rules, whereas here the regulation requires only UCC perfection of the agency's security interest in any new property bought with collateral proceeds. But the Government has plainly failed to read all of its own regulations. FmHA, in fact, is required by its own regulations to comply with the UCC rules governing perfection of its security interest in farm commodities, continuation of perfection, and termination of the security interest. 9 C.F.R. §§1962.5(a),(b),(d); 1962.24. FmHA must also specifically comply with the UCC rules governing a debtor's requests for information concerning the security and unpaid balance of FmHA indebtedness covered by the UCC financing statement. 9 C.F.R. §1962.14. Clearly, *Kimbell* cannot be distinguished on this ground.

Significantly, the Government says nothing about the congressional policy which this Court explained in *Kimbell Foods* as the basis for its decision that state commercial law should govern FmHA security interests. Nowhere in its opposing brief does the Government explain how the

Eighth Circuit result can square with the congressional desire to subject FmHA to the rigors and incentives of the marketplace so that it efficiently manages its loans.

2. The Conflict Among the Circuits

The Government tries to paper over the inter-circuit conflict by contending that none of the cases cited in the Petition from other circuits involved the application of a federal regulation. The reason for that, of course, is that those circuit courts understood *Kimbell* to require the application of state law, which they then applied. *See also* the recent decision by the Fourth Circuit in *United States v. Tugwell*, ____ F.2d ____ (4th Cir. 1985) (slip op. attached hereto as Appendix G), in which *Kimbell Foods* was specifically followed in applying the North Carolina UCC to the sale of FmHA collateral.[2]

3. The Different Result Under Incorporated State Law

The Government's contention that the decision below might not change if state law were applied must be rejected out of hand. The governing state law decision, *CharterBank Butler v. Central Cooperatives, Inc.*, 667 S.W.2d 463, 466 (Mo.App. 1984), specifically held that a secured party's consent to collateral sales, provided that the sales proceeds are then paid to the secured party, operates as consent under the UCC and absolves the purchaser of any liability even if the proceeds are not remitted to the lender. *CharterBank* is but one in a series of UCC decisions in recent years in various states that consent to sales conditioned on the debtor's specified use of the proceeds after the sales, frees the collateral of the security interest even if the debtor fails to make the specified use of the proceeds. *See Peoples National Bank v. Excel Corp.*, 695 P.2d 444, 448-450 (Kan. 1985); *Colorado State Bank of Walsh v. Hoffner*, 701 P.2d 151, 153 (Colo. App. 1985); *Anon, Inc. v. Farmers Production Credit Ass'n*, 446 N.E.2d 656, 662 (Ind.App. 1983); *National Livestock Credit Corp. v. Schultz*, 653 P.2d 1243, 1244-1247 (Okl.App. 1982); *Western Idaho Production Credit Ass'n v. Simplot Feed Lots, Inc.*, 678 P.2d 52, 55-56 (Idaho 1984); *Ottumwa Production Credit Ass'n v. Heinhold Hog Market, Inc.*, 340 N.W.2d 801, 802-803 (Iowa App. 1983). As a leading commentator has concluded:

> [T]hese decisions make good sense because they allow Article 9 to dovetail with the standard practice of consenting to the sale of the farm products on the condition that the proceeds be remitted for payment of the loan. The secured creditor should not have the best of both worlds: an anti-sale provision in the security agreement which is ignored so long as the loan is being paid but is suddenly relied upon when the debtor falls into default. Under these circumstances, the courts should bend over to protect the ordinary course buyer and to promote ready exchange in the agribusiness marketplace. [B. Clark, Law of Secured Transactions, 1983 Cum.Supp. No. 2, ¶8.4[3][b], at S.8-7.][3]

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[2] "The relevant federal law is, by adoption, local state law, here the law of North Carolina, because the need for national uniformity is not great, adoption of North Carolina law will not frustrate the FmHA program, and adoption of a rule different from local law could disrupt local practice." (App. G at G-3.)

[3] The Government's specious argument that UCC §9-307(1), Mo. Rev.Stat. §400.9-307(1), may somehow result in a FmHA recovery under state law must be rejected out of hand. Section 9-307 applies "only to unauthorized sale by the debtor." Official UCC Comment to §9-307, §2.

4. The Unfairness of the Result

The Government also argues that the decision below is not unfair and does not result in windfall damages for FmHA because FmHA was simply recovering the sale proceeds of its collateral. But the unfairness is palpable once it is understood that petitioner would not be liable under state law, acted innocently and in good faith, which is not denied, and is not being forced to pay the actual sales proceeds to the Government, but rather to indemnify FmHA for its debtor's default by paying *twice*, once to the debtor-seller and now again to the Government.

5. The FmHA Regulations Eliminate the Consent Defense and Guarantee FmHA Recovery

The Government, finally, suggests that the decision below does not result in a fundamental change in commercial practice because even under state law the security interest would continue in collateral that is sold unless the sale is authorized by the secured party. Thus, according to the Government, petitioner would still have to take steps to determine whether the commodities it buys are subject to a security interest. This ignores the critical fact that the decision below *eliminates* the consent defense available under state law and that in virtually all instances, as here, it is standard practice for the secured party to consent to the sales of the farm product collateral. *See* Clark, *supra*, 1983 Cum.Supp. No. 2; *see also First National Bank and Trust Co. of Oklahoma City v. Iowa Beef Processors, Inc.*, 626 F.2d 764, 767 (10th Cir. 1980): "The reality of cattle financing arrangements is that the secured party expects and wants the collateral to be sold continually in order for it to receive payment on the line of credit it has extended." Thus if state law applied, petitioner would have to worry only about those rare in-

stances in which the farm products are sold without the consent of the secured party, whereas under the Eighth Circuit decision petitioner is potentially liable for every purchase of FmHA collateral regardless of FmHA's consent.

Moreover, the decision below insures that the Government will "always prevail, without regard for the status or rights of the competing party under state law. Clearly, the Department of Agriculture could not have dictated that result, nor did it intend to in the regulation on which [FmHA] relies." *Central Livestock*, 616 F.Supp. at 633.

CONCLUSION

This Court's *Kimbell Foods* decision provides that state law governs FmHA security interests as incorporated federal law unless Congress directs otherwise, which it has not, or there is "concrete evidence that adopting state law would adversely affect administration of the federal programs." 440 U.S. at 730. The Eighth Circuit refused to follow *Kimbell* despite the absence of any such "concrete evidence," and the Government in this Court makes no claim that there is such evidence.

This Court should, therefore, grant plenary review in this case to put an end to the persisting confusion and inconsistent results arising over this choice of law issue in the hundreds of pending FmHA cases. As the eloquent *amicus* brief of the National Council of Farmer Cooperatives demonstrates, the decision below "has created chaos in farm commerce and credit." (*Amicus* Br. 9.) Settling the issue once and for all will lessen court congestion and costs and allow agricultural commerce to proceed as

before under the neutral, fair rules of the UCC. For these reasons, as well as for the need to reverse an unfair and erroneous decision, petitioner asks that certiorari be granted.

Respectfully submitted,

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DATED: January 10, 1986

APPENDIX G

United States of America, Appellant, versus
Richard E. Tugwell, Appellee

No. 85-1157

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

Slip Opinion

Argued August 1, 1985

September 25, 1985

APPEAL-STATEMENT:

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro. Richard C. Erwin, District Judge. (C/A 84-435)

COUNSEL:

Richard L. Robertson, Assistant United States Attorney (Kenneth W. McAllister, United States Attorney on brief) for Appellant.

Daniel E. Garner (Richard M. Hutson, II on brief) for Appellee.

OPINION:

Before PHILLIPS and SNEEDEN, Circuit Judges, and JONES, United States District Judge for the Western District of North Carolina, sitting by designation.

PER CURIAM:

The Farmers Home Administration (FmHA), a secured party holding a perfected security interest in farm equipment, sued Richard E. Tugwell for conversion after Tugwell bought the equipment from the debtor. FmHA alleged that the equipment, a grain combine, broke down during its use by Tugwell and that Tugwell has wrongfully deprived FmHA of its rights to the combine. The issue is whether, under the facts alleged by FmHA, Tugwell is entitled to summary judgment. The district court found that although the facts technically established conversion, the case was not an appropriate one for maintenance of a conversion action and gave summary judgment for Tugwell. We reverse.

I

FmHA took a security interest in a grain combine owned by Thurgood M. Bradshaw as a security for loans Bradshaw owed to FmHA. Bradshaw sold the combine to Tugwell, who apparently was unaware of FmHA's security interest, without the authorization of FmHA. Tugwell used the combine for a short time until it broke down, and thereafter, he stored the machine after removing its wheels. FmHA was unable to locate Bradshaw in order to collect its loans, and therefore, filed suit against Tugwell for conversion seeking the fair market value of the combine at the time of conversion as damages. Tugwell offered to replace the wheels and tender the combine to FmHA, but only on the condition that FmHA pay him for storage expenses.

When the Government sued Tugwell for conversion, the district court granted summary judgment to Tugwell on the basis that under relevant federally adopted state law, conversion was not an available remedy to the FmHA as holder of a security interest. This appeal by the Government followed.

II.

Federal law governs this dispute concerning FmHA's rights under a nationwide federal program. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726-27 (1979). The relevant federal law is, by adoption, local state law, here the law of North Carolina, because the need for national uniformity is not great, adoption of North Carolina law will not frustrate the FmHA program, and adoption of a rule different from local law could disrupt local practice. See *id.* at 728-40; *United States v. Friend's Stockyard, Inc.*, 600 F.2d 9, 10 (4th Cir. 1979).

Under N.C. Gen. Stat. § 25-9-306(2), FmHA's security interest continued in the combine after the sale to Tugwell because FmHA did not authorize the sale and Tugwell did not qualify for protection under § 25-9-307. Official Comment 3 to § 306 states that § 306(2) allows the secured party to obtain satisfaction against either proceeds in the hands of the debtor or the collateral in the hands of the purchaser. The Official Comment there states that "the secured party may repossess the collateral from [the transferee] or in an appropriate case maintain an action for conversion." (Emphasis added.)

Under North Carolina law, FmHA must prove its interest in the combine and Tugwell's unauthorized dominion over it to establish a cause of action for conversion. See *Peed v. Burleson's, Inc.*, 244 N.C. 437, 94 S.E.2d 351, 353 (1956). FmHA's security interest in the combine is a sufficient interest to ground an action for conversion. See *United States v. Pete Brown Enterprises, Inc.*, 328 F. Supp. 600 (N.D. Miss. 1971) (applying North Carolina law); see also N.C. Gen. Stat. § 25-9-306 Official Comment 3. In addition, Tugwell's act of taking possession of the combine with intent to acquire in it a proprietary interest that Bradshaw was not empowered to give represents sufficiently serious unauthorized dominion over the combine to fulfill the second element of the tort. See Restatement (Second) of Torts § 229 & comment b (1966).

III

The district court found that FmHA had technically established that Tugwell converted the combine. This finding is not clearly erroneous since FmHA established its ownership interest in the combine and serious unauthorized dominion over it by Tugwell.

Nevertheless, the district court gave summary judgment for Tugwell after noting that N.C. Gen. Stat. § 25-9-306 Official Comment 3 states that the secured party may sue for conversion in appropriate cases. Apparently construing the "appropriate cases" reference as conferring judicial discretion to withhold the remedy due to equitable considerations, the court held that this was not an appropriate case for maintenance of a conversion action. In the court's view, FmHA had a security interest in the proceeds of the sale in the hands of Bradshaw, the debtor, and in the interests of fairness it should be required to seek those proceeds before seeking conversion damages against Tugwell, the transferee.

We disagree with the district court's interpretation and application of the "appropriate case" reference. We conclude that it simply means that where the facts justify recovery of damages for conversion, this is an appropriate alternative remedy that may be pursued by the security interest holder. In *Pete Brown Enterprises*, 328 F. Supp. at 605-06, the court noted that North Carolina law "does not impose upon the secured creditor a legal duty to proceed against the debtor as a prerequisite to suit against a converter." Indeed, the Official Comment states that the "secured party may claim both proceeds and collateral, but may of course have only one satisfaction." The "appropriate case" language of the Official Comment therefore means only that the traditional elements of the conversion action must of course be present, not that other remedies must have been exhausted, or that exhaustion can be judicially required as a prerequisite to invocation of the conversion remedy.

IV

Hence we reverse the grant of summary judgment for Tugwell, affirm the finding that Tugwell converted the combine, and remand for entry of partial summary judgment in favor of the Government on the issue of Tugwell's liability. The measure of damages for conversion is fair market value of the converted property at the time of conversion plus interest. *Crouch v. Lowther Trucking Co.*, 262 N.C. 85, 136 S.E.2d 246, 247 (1964). The issue of damages due under that measure remains for determination upon remand.

REVERSED AND REMANDED.